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SUBJECT: ANHUI'S AUTO INDUSTRY HURT BY ECONOMIC DOWNTURN, BENEFITS  
FROM GOVERNMENT STIMULUS MEASURES

REF: a) 07 SHANGHAI 284; b) SHANGHAI 79

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11. (SBU) Summary: After years of double-digit growth, Chery  
Automobile Company and Jianghuai Automobile Company (JAC), two  
large Chinese auto manufacturers headquartered in Anhui  
Province, saw sales slump in 2008 due to the economic downturn,  
with exports hit particularly hard. Recent government measures  
to stimulate growth, such as a tax cut on small sedans, lifted  
sales in January. The companies are cautiously optimistic that  
additional government measures, including subsidies to rural  
consumers, will boost domestic sales in 2009. End summary.

Background: Rapid Growth  
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12. (SBU) Feng Ping, Vice General Manager in charge of  
international relations at Chery Auto, described the company's  
rapid growth during a meeting in Wuhu, Anhui Province on  
February 17. Based in Wuhu and founded in 1997 as an auto parts  
manufacturer with two factories, Chery manufactured its first  
passenger vehicle in 1999. By 2006, Chery had manufactured a  
total of 500,000 vehicles, and in August 2007, the company  
rolled out its 1 millionth vehicle. Chery's current annual  
capacity is 650,000 cars. It has four factories, all in Wuhu,  
employing 23,000 workers. Chery's sales have grown quickly.  
The company sold only 28,610 cars in 2001 but sold 305,236  
vehicles in 2006 and 356,000 in 2008. Chery has 500  
distribution service centers throughout China as well as a  
global distribution network covering several dozen countries.  
Total export volume has grown exponentially from 100 vehicles in  
2002 to 50,000 in 2006 and 135,000 in 2008. Exports now account  
for 30 percent of total sales; its major export markets include  
Russia, Eastern Europe, Latin America, Africa, and the Middle  
East. "We export to everywhere except North America and Western  
Europe," said Feng. (Note: For more on Chery's background, see  
ref A. End note.)

13. (SBU) Gong Renhe, Deputy President of Jianghuai Automobile

Company (JAC), described his company's wide-range of vehicles during a discussion on February 18 in Hefei, the provincial capital of Anhui Province. Established in 1999 and based in Hefei, the company makes light trucks, heavy commercial trucks, bus chassis, auto parts, minivans, and construction vehicles. It also launched its first sedan in 2008. Company sales have grown 30 percent every year, reaching 210,000 vehicles in 2007 and a "similar figure" in 2008, according to Gong. Minivans account for a large portion of total sales. According to Huang Junchun, Deputy Director of the External Relations Department at JAC, the company sold 40,000 minivans in 2008, placing it among the top two minivan manufacturers in China. Econoff visited JAC's minivan factory, which churns out 150 to 200 vehicles a day. JAC's exports have also grown in recent years. Exports account for 10 percent of JAC's total sales, amounting to 8000 vehicles in 2006, 20,000 in 2007, and 24,000 in 2008. Chief export markets include Southeast Asia, the Middle East, Russia, and Africa, said Huang. JAC's employees have increased from 16,000 in 2006 to over 20,000 now. According to Huang, JAC recruits university graduates majoring in automotive studies from across China, many from technical colleges in Northeast China. Though he did not provide exact figures, Huang said the attrition rate is low, as JAC employees have ample opportunity for career advancement through examinations and good performance. (Note: For more on JAC's background, see ref A. End note.)

#### Hitting a Speed Bump: The Global Financial Crisis

14. (SBU) The global financial crisis hit both Chery and JAC hard in 2008. Chery's total sales decreased from 381,000 vehicles in 2007 to 356,000 in 2008, the first year-on-year decline since the company's founding, according to Feng Ping.

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The company originally planned to introduce six new models in 2008 but ended up launching only one because of the economic downturn and technical problems requiring additional tests and certification. The financial crisis has impacted Chery more than other Chinese auto makers because of the company's heavy reliance on overseas markets (30 percent of total sales), said Feng. January exports this year were down 70 percent from January 2008, with sales to Russia and Ukraine hit hardest. Feng attributed this to Russia's slowing economy, depreciating currency, and 5 percent rise in Russia's import tax on cars. Exports to Latin America and the Middle East are still "so-so," said Feng, and the company recently launched a new "global model" sedan called the M11, which has seen sales pick up after a slow start since the company recently slashed prices. Despite the downturn, the company does not plan to layoff employees, said Feng.

15. (SBU) JAC's sales were healthy through the first half of 2008 but declined sharply after July 2008, said Gong Renhe. Sales for the full year were up only 10 percent from 2007, a sharp drop from previous years' 30 percent annual growth. JAC's sedans, which the company launched in 2008, faced a slow start due to "fierce competition" exacerbated by the financial crisis, said Huang Junchun. Although exports (which account for 10 percent of JAC's sales) grew 10 percent in 2008 from the previous year, JAC "will face a lot of pressure" in overseas markets in 2009, speculated Gong. Exports to the Middle East and Africa have been hit especially hard. Huang said the company does not plan to layoff workers despite the downturn.

#### Boosted By Stimulus Measures

16. (SBU) China's economic stimulus measures have had a notable impact on Chery and JAC, said our interlocutors. The Chinese Government recently halved the purchase tax from 10 percent to 5 percent on cars with engines 1.6L and smaller, spurring demand for Chery's sedans, 90 percent of which are under 1.6L, according to Feng Ping. Though sales are still down from January 2008, Feng said Chery's domestic sales in January 2009 rose 20 percent from December 2008, calling the tax cut a "gift from the government for the Chinese New Year." (Note: Japanese

analysts said during a separate discussion on February 9 that Japanese automakers saw sales in China rise in December 2008 and January 2009 but attributed this to a sharp cut in prices by manufacturers. Ref B. End note.) Feng also expects Chery to benefit from another government plan, due to be implemented in March, which aims to boost rural consumption by subsidizing the purchase of low-emission vehicles, including sedans, in rural areas.

17. (SBU) Gong Renhe hopes the recent tax cut will raise sales of JAC's small sedans. However, he thinks the government's effort to boost rural consumption through subsidies will have the biggest impact on JAC's sales, since the company's light trucks and minivans are widely used in rural areas. Infrastructure development projects should benefit JAC's construction vehicles, such as its cement mixers and heavy loader trucks, said Huang Junchun. The Chinese Government in February also announced cash rebates for the purchase of fuel efficient and alternative energy vehicles in 13 designated cities across China, including Hefei, where JAC is based, noted Gong. (Note: The other cities designated for the project are Beijing, Shanghai, Chongqing, Changchun, Dalian, Hangzhou, Jinan, Wuhan, Shenzhen, Changsha, Kunming and Nanchang. End note.) Gong expects sales of JAC's buses to increase as Hefei switches to more fuel efficient modes of public transportation.

#### Looking Ahead: Optimism Despite Uncertainty

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18. (SBU) Feng Ping said it is difficult to forecast sales for 2009 but that Chery remains fairly optimistic about the domestic market. She said the company plans to launch over 10 new models in 2009 but admitted there "may be some delays," depending on

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the economic situation. Some of the company's new cars are aimed at niche markets, such as the "QQme," a smaller version of their popular QQ model tailored specifically for young female drivers and scheduled to be launched next month, according to Feng. The company is already producing a BSG (belt starter-generator) hybrid sedan, and Feng expects the company to roll-out an ISG (integrated starter-generator) hybrid in 2009. Feng, however, is unclear how the economic downturn will affect Chery's development of hybrids but speculated there may be delays in some new energy vehicle projects. Although Chery hopes to export 150,000 vehicles this year (a 10 percent increase on 2008), Feng thinks this target may be "difficult" to achieve. She expects Chery to focus on the domestic market this year but said the company will have to eventually expand abroad to become a "powerful" player able to compete with better-known brands in the auto industry. Chery is thus looking to improve the quality of its cars by investing RMB 1.7 billion in a new testing facility utilizing state-of-the-art equipment from Germany and Japan, according to Feng. On the other hand, Chery is delaying construction of its fifth factory due to economic uncertainties, said Feng.

19. (SBU) Huang Junchun of JAC forecasted "small growth" for his company in 2009. The company cut several projects this year due to concerns over cash flow but still expects to launch "at least" one new 1.5L sedan this year. Huang said JAC will focus on the domestic market, especially rural areas, in 2009, but the company is also looking at other areas of potential growth, such as overseas markets and new energy vehicles. JAC hopes to increase its exports to 15-20 percent of total sales within the next few years, according to Huang. JAC is also developing new electrical buses to take advantage of environmental initiatives in Hefei and other large cities. The company receives local government funding for R&D of alternative energy vehicles, Huang added.

#### Working With Foreign Suppliers

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110. (SBU) According to Feng Ping, Chery has partnerships with U.S. localized companies in China, such as Johnson Controls and Lear Corporation, which provide various auto components. Though the company procures most of its parts domestically from both

Chinese and foreign-owned suppliers, it also imports superchargers, electronic control units (ECU), and other specialized components from the United States, said Feng. Chery also imports high precision measurement equipment and machine tools from Germany and Japan. Feng noted that the company invited several German engineers to train employees, and that a German national who used to work at Volkswagen for 45 years now supervises the R&D center at Chery.

¶11. (SBU) JAC has 500-600 suppliers, of which 40 percent are in Anhui and 60 percent in other parts of China, said Gong Renhe. The company set up a "supplier network" at the end of 2007 with "clusters" of suppliers located in and around Hefei, some of which are foreign-owned joint ventures (JVs), according to Gong. JAC currently imports a few components for its minivans but procures most of its parts from domestic (Chinese and foreign JV) suppliers, including U.S.-owned Johnson Controls, Lear Corporation, and Visteon. Although JAC's 11 subsidiaries each have their own purchasing departments, the company plans to set up a new Investment Management Department which will coordinate requests for investment and business opportunities, said Gong.

Comment

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¶12. (SBU) Econoff observed that nearly all sedans on the streets of Wuhu, where Chery is based, were Cheries. Hefei, the hometown of JAC, had a mix of different brands (although most of the taxis in Hefei appeared to be Cheries). It is not clear what incentives Wuhu residents and taxi companies receive for driving Cheries, if any, but both auto makers receive significant support from the local government, such as

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preferential tax treatment and R&D funding, according to the interlocutors. A local resident in Hefei driving a Shanghai GM Buick, however, laughed at the idea of buying a Chery, commenting that Hefei residents who can afford to buy cars prefer GMs or Volkswagens, while others just do not buy cars. The resident added that foreign cars made in China, such as Shanghai GM, do not cost a great deal more than Cheries but are better quality. Feng Ping of Chery acknowledged to Econoff that Chery's greatest challenge in the future will be to improve its quality and reputation, even among locals, and make it a "cool" car to drive.  
CAMP